

The University of Chicago

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SOUTH AMERICAN GOVERNMENTS,
1919-30

A PART OF A DISSERTATION SUBMITTED TO
THE FACULTY OF THE DIVISION OF THE
SOCIAL SCIENCES IN CANDIDACY FOR THE
DEGREE OF DOCTOR OF PHILOSOPHY

DEPARTMENT OF POLITICAL SCIENCE
SEPTEMBER, 1943

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This work is an historical and political analysis of the dollar bonds of seven South American governments during the period, 1919-30, and the methods by which these bonds were sold to the American investors. The bonds are listed with the names of the issuing houses, and each bond is discussed in detail. Certain mistakes in judgment made by the houses of issue and the various governments are shown, and the parts played by the United States Department of State, the Department of Commerce, and the Foreign Bondholders' Protective Council are explained.

Chapter I, "The Loans," begins with a brief review of the three periods of the financial history of the United States. By 1919, if intergovernmental loans be included, the United States was a net creditor nation to the amount of approximately \$14,100,000,000.¹ The United States during the 1920's maintained a favorable balance of trade, partly due to a high protective tariff, and sought to furnish debtor nations with dollar exchange to buy American products by means of an extensive export of capital.²

By 1930, the American investors had placed \$1,380,000,000, excluding refunding issues, in South American governmental securities, an amount which was 22.5 per cent of their total investments in all bonds of foreign governments.³ During the period, 1919-30, South American governments floated in the United States \$1,720,282,000 of dollar bonds, including refunding issues, a total exceeded only by the amount of European governmental bonds floated in the United States during the same period.⁴

¹ John T. Madden, Marcus Nadler, and Harry C. Sauvain, America's Experience as a Creditor Nation (New York: Prentice-Hall, Inc., 1937), p. 54.

² Royal Institute of International Affairs, The Problem of International Investment (London: Oxford University Press, 1937), p. 171.

³ League of Nations, Memorandum on Trade and Balances of Payments, Vol. II, "Balance of Payments" (Geneva: League of Nations, 1930), p. 179.

⁴ See Chart II in "Dollar Bonds of South American Governments, 1919-30," and the footnote to this chart. (See complete dissertation in files of the University of Chicago libraries.)

Argentina borrowed more money in the United States than any of the other South American governments; her total was \$486,353,000, or 28.27 per cent of the amount borrowed by all South American governments.¹ A table shows the dollar bonds of Argentina, 1919-30, which were publicly offered and issued for a term of at least five years, exclusive of bank credits and short-term treasury notes. Each bond is listed in detail, naming the borrower as the National Government, a province, or a municipality, giving the year of the loan, the amount, the price paid to the borrower by the banker, the issue price, the nominal interest, the real interest paid (the yield of the bond based upon the price paid to the borrowing government, the nominal interest rate, and the maturity of the issue), and the name of the originating banker.²

The National Government of Argentina issued eleven dollar loans in the United States for a total amount of \$316,800,000, or 65.14 per cent of all Argentine loans; the Argentine provinces borrowed \$141,536,000, or 29.1 per cent of the total; the municipalities issued \$28,017,000 of dollar bonds, or 5.75 per cent of the total amount of Argentine issues in the United States.³ The prices paid to the Argentine government by the bankers ranged from 92 to 95 1/2, and the real interest rate paid ranged from 5.883 per cent to 8.24 per cent. In the case of the provincial loans, the prices paid by the bankers ranged from 85 to 92.41 and the real interest paid varied from 6.558 per cent to 8.505 per cent.

Brazil borrowed \$448,030,000, thirty-nine per cent of which were issued by the National Government, thirty-nine per cent by the states, and the remainder by the municipalities.⁴ A table

¹See Chart III in "Dollar Bonds of South American Governments."

²See Table 1 in ibid.

³Ibid. The information upon which this table is based may be found in U. S. Congress, Senate, Committee on Finance, Sale of Foreign Bonds and Securities in the United States, Hearings Pursuant to S. Res. 19, 72d Cong., 1st Sess. (Washington: U. S. Printing Office, 1931); U. S. Congress, Senate, Committee on Banking and Currency, Stock Exchange Practices, Hearings on S. Res. 84, 56, and 97, 73d Cong., 2d Sess. (Washington: U. S. Printing Office, 1933).

⁴See Table 2 in "Dollar Bonds of South American Governments." The information upon which this table is based may be found in Committee on Finance, op. cit., Committee on Banking and Currency, op. cit.

lists the loans floated by Brazil from 1919 to 1930, the year, amount, price paid, issue price, nominal interest, real interest paid, and the name of the banker.¹ The prices paid the National Government by the bankers ranged from 84 to 91; the real rate of interest varied from 7.512 per cent to 9.094 per cent. In the case of the state loans, the prices paid by the bankers ranged from 82.23 to 93.5; and the real interest paid, from 7.185 per cent to 9.013 per cent. Of the total of \$448,030,000, the National Government borrowed \$176,500,000, the states \$176,610,000, and the municipalities \$94,920,000.

Chile, during this period, borrowed \$340,112,000, of which 94 per cent, or \$318,912,000, were floated by the National Government or the Mortgage Bank of Chile, and the remainder by the municipalities.² A table deals with these bonds in detail.³ The prices paid the National Government by the bankers ranged from 87.13 to 95.50; the real interest paid varied from 6.618 per cent to 8.635 per cent. The prices paid the municipalities ranged from 92 to 96.3, and the real interest varied from 7.348 per cent to 7.679 per cent.

Colombia borrowed \$182,035,000 through dollar bonds from 1919 to 1930, of which the National Government and the Agricultural Mortgage Bank borrowed \$81,000,000, or 45 per cent of the total; the Colombian departments floated \$71,950,000 of dollar bonds, or 40 per cent of the total; the remainder, \$29,085,000, was borrowed by the municipalities.⁴ The prices paid the National Government by the bankers ranged from 88.5 to 93.5; the real interest paid varied from 6.659 per cent to 8.582 per cent. In the case of the departments, the prices paid ranged from 83 to 92 1/2; and the real interest paid, from 7.456 per cent to 9.33 per cent. The prices paid the municipalities ranged from 85 to 90, and the real interest paid varied from 7.453 per cent to 10.273 per cent.⁵

¹See Table 2, "Dollar Bonds"

²See Table 3, ibid. The sources are the same as in footnote 4, supra, p. 2.

³Ibid.

⁴See Table 4, ibid. The information for this table may be found in U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Trade Promotion Series, No. 104, Handbook of American Underwriting of Foreign Securities (Washington: U. S. Printing Office, 1930).

⁵See Table 4, "Dollar Bonds"

All governmental entities of Peru borrowed a total of \$129,500,000, of which 96 per cent, or \$125,000,000, were borrowed by the National Government, \$1,500,000 by a province, Callao, and \$3,000,000 by the City of Lima.¹ The prices paid varied from 86 to 96, and the real interest paid for the loans ranged from 7.105 per cent to 9.094 per cent.

The National Government of Bolivia floated six dollar loans aggregating \$68,000,000, the prices paid ranging from 87 1/2 to 93, and the real interest paid varying from 7.529 per cent to 9.329 per cent.²

Uruguay borrowed \$66,252,000, of which amount the National Government obtained \$55,081,000 and the City of Montevideo \$11,171,000.³ The prices paid ranged from 89.95 to 95.02, and the real interest paid varied from 6.361 per cent to 8.691 per cent.

Chapter 11, "The Bankers: Profits and Methods," is a survey of the issuing houses for the South American dollar bonds of 1919-30. The ten banking houses which managed the flotation of the greater amount of the loans are as follows: Hallgarten and Company, \$253,495,500 par value of dollar bonds; Blair and Company, \$196,194,500; Dillon, Read, and Company, \$190,500,000; J. P. Morgan and Company, \$183,800,000; National City Company, \$139,912,000; Kuhn, Loeb and Company, \$130,000,000; J. and W. Seligman and Company, \$107,500,000; Speyer and Company, \$82,500,000; White, Weld and Company, \$75,627,500; Chase Securities Corporation, \$69,060,000.⁴ The average gross spread in points of the managing bankers ranged from 12.6 in the case of the Central Trust Company of Illinois to 2.94 in the case of White, Weld and Company.

The gross bankers' profits on South American dollar bonds during the period, 1919-30, must have been over \$88,000,000.⁵ This gross profit includes the profits of the managing bankers, intermediate bankers, and the retail bankers who sold the securities to the public. It is impossible to estimate the net profits

¹See Table 5, "Dollar Bonds of South American Governments."

²See Table 6, ibid.

³See Table 7, ibid.

⁴See Chart IV, ibid. The information upon which this chart is based may be found in Committee on Finance, op. cit., and Committee on Banking and Currency, op. cit.

⁵See Chart V, ibid. This has been calculated by the author by multiplying the gross spreads by the par values of the issues floated by each banker.

because of the difficulties involved in allocating overhead expenses, and the insufficiency of data as to the bankers' expenses. Fourteen bankers managed loans, whose gross profits exceeded \$1,000,000.¹ These gross profits ran from a high of \$11,570,500 in the case of loans managed by Dillon, Read, and Company to a low of \$1,869,377 in the case of the First National Corporation.

In addition to profits derived by the investment bankers from the gross spreads, small profits were made through fiscal agency agreements, connections with, and ownership of, contracting firms engaged in public works, and perhaps in the calling of loans before maturity at prices above par. Although it is impossible to estimate the profits derived from the above sources, examples may be given to show that the profits were substantial.

In the case of a \$30,000,000 loan of 1926 for the Republic of Uruguay, Hallgarten and Company and Halsey, Stuart and Company were appointed fiscal agents. The fiscal agents were allowed to pay Uruguay an interest rate on money kept on deposit, which interest rate was 2 per cent below the New York Federal Reserve Bank rate for ninety days' prime bankers' acceptances.² In addition, the fiscal agents received a commission of one-eighth of one per cent on all funds which they disbursed either in payment of interest or principal.

In the case of the City of Rio de Janeiro loan of 1921 for \$12,000,000 for the purpose of demolishing Castle Hill, Dillon, Read, and Company designated Kennedy and Company as the contractor for the work in the loan contract.³ There was no bidding on the contract, and it was done upon a cost-plus basis. A 45 per cent interest in Kennedy and Company was owned by Mr. Dillon's family. Such contracts raise the question as to whether the banker did not encourage unsound loans by the government in order to obtain business for his contracting firm.

In some cases, the loan contracts specified that, in case bonds were called prior to maturity, a price of par or above par should be paid for the bonds. In case bonds were called prior to

¹Ibid.

²See loan agreement in Committee on Finance, op. cit., Part II, p. 1159.

³Committee on Banking and Currency, op. cit., Part IV, pp. 1907-10. Testimony of Robert Otis Hayward, a member of the banking firm of Dillon, Read, and Company.

maturity, the bankers by buying up depreciated bonds could reap substantial profits, especially since the fiscal agents would presumably have advance information as to the calling of the bonds. Although it is impossible to determine the profits made by such a procedure, examples may be given which would have permitted substantial profits by prior buying of dollar bonds. The \$24,000,000 Republic of Chile dollar loan of 1921, which was a twenty year maturity issue, was called in seven years at 110.¹ This issue had been managed by J. P. Morgan and Company. The \$7,000,000 Peruvian loan of 1924, which was a twenty year maturity bond, was called in 1927-28 at 110.²

The average gross spread on all South American governmental loans during the period, 1919-30, was 5.13 per cent.³ The variations from the average gross spread were, however, great. The average gross spread of one of the fourteen bankers who managed loans with gross profits of more than \$1,000,000 was less than three points, while two bankers in this same group had gross spreads of over eight points.⁴ In general, these fourteen bankers could be divided into two groups in respect to their average gross spreads. Six bankers had average gross spreads of 5 points or less, while eight had gross spreads of over 5 points. The highest average gross spread of the six bankers with the lower gross spreads was that of 4.24 points by the National City Company. The lowest gross spread of the eight highest bankers was that of 5.7 points which was the spread of J. and W. Seligman and Company. The difference between the highest of the lowest six bankers and the lowest of the eight highest bankers in respect to average gross spread was 1.46 points. The difference in average gross spreads between the two groups of bankers is quite pronounced; if a frequency graph were drawn, the curve would be distinctly bimodal.

In order to determine the factors which influenced the gross spreads, the bonds were divided into groups, and frequency curves made of many of the groups in order to detect similarities and differences. The first frequency curve was drawn of the gross spreads of the 110 dollar bonds for which the gross spreads were

¹Committee on Finance, op. cit., Part I, chart facing p. 162.

²Ibid., Part III, pp. 1733-34.

³Computed by the author.

⁴Computed by the author.

known. The median gross spread was 5.5 points, and the curve skewed to the right, or toward the higher gross spreads.¹ This skewness indicated that there was more variation in the gross spreads higher than the median than among those lower than the median.

The dollar bonds were then placed in four groups in accordance with initial ratings by Moody. The four curves indicate that the supposed soundness of the bond does affect the gross spread. The median of the group with the highest rating was 3.125 points, while the median of the group with the lowest rating was 7.66 points. There were wide variations, however, within each group in respect to the gross spreads, and these variations increased as the rating of the bonds became lower.²

The gross spreads of dollar bonds of the seven national governments of South America which had borrowed money from the United States were plotted by years. In general, the trend of the gross spreads was to decrease slowly from 1921 through 1926.³ The gross spreads of the Brazilian National and Peruvian National issues were inverse to the general trend in that the gross spreads in the case of these loans tended to become larger rather than smaller.

The relationship between the nominal interest rates and the gross spreads of the dollar bonds of South American national governments was generally positive, although in the cases of Bolivia and Brazil the relationship was primarily inverse.⁴ In the cases of Bolivia and Peru there were some cases where the gross spread exceeded the nominal interest.

The relationship between the issue price and the average gross spreads was primarily inverse.⁵ In the cases of Bolivia and Colombia, the correlation was positive. In the case of Chile no discernible correlation can be observed. In general, the issue price was more unstable than the gross spread.

The amount of issue also has something to do with the

¹See Chart VII and Table 10 in "Dollar Bonds of South American Governments."

²See Chart VIII and Table 11, ibid.

³See Table 12, ibid. ⁴See Table 13, ibid.

⁵See Table 14 and Charts IX and X, ibid.

gross spread. The gross spread of the smaller issues is generally higher than that of the larger issues. The median gross spread of issues under \$5,000,000 is 7 points, while the median of those issues of \$20,000,000 and over is only 4.12 points.¹ The group of issues of a nominal amount of between \$10,000,000 and \$20,000,000 had a higher median gross spread than the group of issues between \$5,000,000 and \$10,000,000. The former group had a median gross spread of 6.5 points, while the latter had a median gross spread of only 5.5 points.

The length of maturity of the issues seemed to have little effect upon the average gross spread unless the maturity was thirty years or more. The South American loans of less than twenty years had a median gross spread of 7.11 points; those from twenty to twenty-five years, a spread of 7 points; those from twenty-five to thirty years, a spread of 7.75; and those with maturities of thirty years or more, a median spread of only 4.5 points.²

The effect of various factors upon the real interest paid was analyzed by comparing similar loans which differed only in respect to one factor. In the case of a \$15,000,000 issue of the National Government of Peru in 1927, Juan Leguía, the son of the dictator of Peru, and a group which included Mr. J. V. Salt, an employee of F. J. Lisman and Company, Harold Bolster, a promoter, and S. A. Maginnis, former American minister to Bolivia, were paid the sum of \$100,000, which amounted to two-thirds of one per cent of the par value of the loan, for bringing the loan to J. and W. Seligman and Company.³ The nominal interest paid upon this loan was 7 per cent, but the real interest paid by Peru was 7.855 per cent. If we compare this loan with a similar loan made to Uruguay, but in which no fee was paid for finding the business, we find that Peru paid about 1.5 per cent more real interest than Uruguay.

In 1922, the National Government of Bolivia issued a \$24,000,000 loan managed by Stifel-Nicholaus and Company. Bolivia had granted the Stifel-Nicholaus Company a preferential option upon the loan in return for a previous short-term loan.⁴ The

¹See Table 15 and Chart XI, *ibid.*

²See Table 16 and Chart XII, *ibid.*

³Committee on Finance, *op. cit.*, Part III, p. 1279. Testimony of Frederick Straus, of J. and W. Seligman and Company.

⁴Margaret Alexander Marsh, *The Bankers in Bolivia* (New York: Vanguard Press, 1928), p. 92.

gross spread on the \$24,000,000 loan was 9 points, and the real interest paid by Bolivia was 8.796 per cent.¹ The absence of competition among bankers for this loan probably tended to raise the real interest paid upon this loan. In 1922, the National Government of Colombia issued a smaller loan for a shorter maturity period, but with a similar rating, through another banker. In the case of the Colombian loan, the real interest paid was only 8.107 per cent, or 0.7 of 1 per cent less than in the case of the Bolivian loan.

In 1926, the Colombian Department of Cauca Valley issued a \$2,500,000 loan through J. and W. Seligman and Company. Phanor J. Eder, a New York attorney, was paid a finder's fee amounting to the equivalent of \$40,000.² The finder's fee in this case amounted to about 1.5 per cent of the par value of the loan. The gross spread upon this loan was 13.5 points, and the real interest paid was 9.337 per cent. In the same year as the Cauca Valley loan, the Colombian Department of Cundinamarca issued a loan through another banker. Although this latter loan had a lower security rating than the Cauca Valley loan, the real interest paid in the latter case was only 8.139 per cent, or approximately 1.2 per cent lower than in the case of the Cauca Valley loan.

From 1925 to 1929, Kuhn, Loeb, and Company managed five loans aggregating \$90,000,000 for the Mortgage Bank of Chile.³ Kuhn, Loeb, and Company entered into an agreement with the Guaranty Company to share in these loans in order to avoid "paying the Chilean Government more than it was entitled to."⁴ The real interest paid by the Mortgage Bank upon these loans varied from a low of 6.618 per cent on a \$20,000,000 loan of 1928 to a high of 7.084 per cent upon a \$10,000,000 loan of 1926.⁵ During this same period, 1926 to 1928, the Agricultural Mortgage Bank of Colombia

¹Ibid.

²Committee on Finance, op. cit., Part III, p. 1794.

³Ibid., Part I, p. 184; Part II, p. 432.

⁴Committee on Banking and Currency, op. cit., Part III, p. 1012.

⁵Committee on Finance, op. cit., Part I, p. 184; Part II, p. 432.

floated four loans aggregating \$16,000,000.¹ The cost of these loans to the Agricultural Mortgage Bank of Colombia ranged from a low of 6.952 per cent upon a five-year loan of \$5,000,000 in 1928 to a high of 8.582 per cent upon a \$3,000,000 loan of 1926. The Agricultural Mortgage Bank of Colombia paid from 0.3 to 1.5 per cent higher for their loans than the Mortgage Bank of Chile did over the same period. It would seem, by comparison, in spite of the monopolistic tendencies inherent in the Mortgage Bank of Chile loans, that the cost of these loans to the borrowing government was a reasonable one.

The lowest cost paid by any South American governmental dollar bond was that paid by Argentina on a \$20,000,000 loan of 1928 with a maturity of thirty-four years.² This issue bore a nominal interest of 5.5 per cent and had a gross spread of only 2.6 points. One of the causes of the low real interest charged on this loan was that 1928, with the possible exception of 1927, was the year of lowest real interest on bonds in the United States. The principal cause of this low real interest, which was only 5.883 per cent, however, seems to have been competition between J. P. Morgan and Company and the Chase National Bank. In 1926, J. P. Morgan and Company issued an Argentine loan with a real interest of 6.399 per cent.³ In 1927, the Chase Securities Corporation issued a \$40,000,000 Argentine loan with a real interest paid by Argentina of 6.326 per cent.⁴ In 1927, also, J. P. Morgan and Company issued another Argentine loan with a real interest rate paid of 6.324 per cent.⁵ The latter loan was followed in 1928 by the \$20,000,000 loan bearing a real interest rate of 5.883 per cent issued by Chase Securities Corporation. The real interest rate on all these Argentine loans was very reasonable. This case is a good example of the way in which healthy competition between bankers lowers the real interest rate to the advantage of the borrowing government.

There seems to have been a certain amount of competition among American bankers for South American governmental dollar bonds. Mr. Grosvenor M. Jones, chief of the finance and invest-

¹Ibid., Part II, pp. 504 and 1136, Tables; Part III, p. 1795.

²Ibid., Table, Part II, p. 424.

³Ibid.

⁴Ibid.

⁵Ibid.

ment division of the Department of Commerce, testified that there was keen competition among American bankers for Latin-American dollar loans.¹ The lenders sought the borrowing countries, except in the case of J. P. Morgan and Company who tried to follow the English example of the borrower seeking the lender. Mr. James C. Corliss, specialist, Latin-American finance, Department of Commerce, testified that he had heard at one time that in Colombia there were twenty-nine representatives of American bankers seeking to float dollar loans for the National Government of Colombia and the various departments.²

The bankers utilized different methods in attempting to overcome this competition with one another. One of the devices was to incorporate in the loan contract an option for all future financing in perpetuum, or over a definite period of time. Bolivia borrowed \$1,000,000 for six months in 1921 from the Stifel-Nicholaus Company of St. Louis.³ Stifel-Nicholaus Company demanded either an exorbitant commission of \$90,000 for the loan, or in the alternative an option on the \$29,000,000 loan of 1922 which the Bolivian government was considering at the time, as well as a preferential option for the next three years on any foreign loan which Bolivia might float.⁴ Bolivia gave Stifel-Nicholaus the option, rather than pay that firm \$90,000. As a consequence, Bolivia was forced to turn down an offer by the National City Bank for a \$25,000,000 loan, a French offer of a \$15,000,000 loan in the spring of 1922, another loan offered by a New York firm, and a 3,000,000 pound, 5 per cent, offer by a London firm in the fall of 1922.⁵ Perhaps as a consequence of this, the gross spread of the loan issued by Stifel-Nicholaus Company under their option was 9 points.

Another method which was used to reduce competition between bankers was for the competitive bankers to join together and share the loans. This method would do away with competitive

¹Ibid., pp. 742-43.

²Ibid., pp. 845-46.

³Marsh, op. cit., p. 97. This is the Bolivian loan for which President Franklin D. Roosevelt evidently apologized to General Enrique Peñaranda, President of Bolivia, on the latter's recent visit to the United States on May 6th and 7th, 1943. See New York Times, May 8, 1943, p. 1.

⁴Marsh, op. cit., pp. 97-98.

⁵Ibid., pp. 105-6.

bidding for the bonds. In the case of the Mortgage Bank of Chile loans, Kuhn, Loeb, and Company and the Guaranty Company, both of whom had been competing for the loans, agreed to share in the flotation of the loans.

In their efforts to obtain South American loans, some bankers offered finders' fees to persons or other banking firms bringing them business. In the case of the \$15,000,000, \$50,000,000, \$25,000,000-£2,000,000 Peruvian loans floated by J. W. Seligman and Company, Juan Leguía, the son of the dictator of Peru, was paid \$415,000 for his participation as one of a group who brought the business to F. J. Lismann and Company and J. and W. Seligman and Company.¹ The whole group, including Juan Leguía, were paid a total of \$533,000. This sum amounted to two-thirds of one per cent on the first \$15,000,000 Peruvian loan, and one-half of one per cent on the remaining \$85,000,000 par value of the loans.²

In connection with a loan of \$2,500,000 to the Department of Cauca Valley, Colombia, Phanor J. Eder, New York attorney, was paid a finder's commission of \$15,000 cash and \$27,000 of Cauca Valley bonds which were worth at that time approximately \$25,000.³ This was a finder's fee of 1 per cent of the par value of the loan which was rather high.

In the \$90,000,000 loans issued by Kuhn, Loeb, and Company for the Mortgage Bank of Chile, Louis Dreyfus and Company, a Paris banking firm, was paid a finder's fee of one-half of one per cent of the par value of the loans, or a total of \$450,000.⁴ Since the Guaranty Company had also been interested in this loan, which had been mentioned to them by Norman H. Davis, the latter gentleman was paid an additional finder's fee of \$35,000 by the banking syndicate and the Guaranty Company.⁵ The paying of finders' fees was undesirable because it encouraged the flotation regardless of

¹Committee on Finance, op. cit., Part III, p. 1279. Testimony of Frederick Straus of J. and W. Seligman and Company.

²Ibid.

³Ibid., pp. 1363-64. Exhibit submitted by J. and W. Seligman and Company.

⁴Committee on Banking and Currency, op. cit., Part III, p. 1128. Testimony of Benjamin J. Bittenweiser, a member of the firm of Kuhn, Loeb, and Company.

⁵Ibid., p. 1013. Testimony of Otto H. Kahn, a partner of the firm of Kuhn, Loeb, and Company.

the soundness of the securities. This practice also increased the cost of floating the loans, and in many cases the additional expense was ultimately passed on to the investing public.

At times the investigations by the bankers of the soundness of the loans were perfunctory or careless. At other times banking firms disregarded the adverse advice of their own investigators and officers. J. and W. Seligman and Company sent Lawrence Dennis down to Peru to investigate the soundness of a \$50,000,000 loan which they were contemplating making in connection with the National City Company. Lawrence Dennis reported to his employers that "the way things were going the loans would be in default within five years," that the balance of the budget was precarious, that Peru was already struggling under a heavy load of debt, that Peruvian borrowing was increasing much faster than the income of the country, and that the financial administration of the country was very loose.¹ J. H. Durrell, vice-president and overseas manager of the National City Bank, wrote Mr. Charles E. Mitchell, president of the bank, that two-thirds of the population lived east of the Andes and consumed practically no manufactured articles, that the population was largely Indian, and that he had no great faith in any material betterment of Peru's economic condition in the near future.² In spite of these rather pessimistic reports, J. and W. Seligman and Company and the National City Company floated the \$50,000,000 loan to Peru.

The first issue of the Mortgage Bank of Chile loans was floated by Kuhn, Loeb, and Company, approximately six months after a revolution had occurred in Chile in which President Arturo Alessandri had been removed and a council of military and naval officers set up to govern the country, and before any intervening election was held.³ Most of the information as to the economic condition of Chile seems to have been accepted by Kuhn, Loeb, and Company from the Chilean ambassador to the United States and the

¹Committee on Finance, op. cit., Part III, p. 1593.

²U. S. Congress, Senate, Subcommittee of the Committee on Banking and Currency, Stock Exchange Practices, Hearings on S. Res. 84 and 239, 72d Cong., 2d Sess. (Washington: U. S. Printing Office, 1933), Part VI, p. 2071.

³Committee on Banking and Currency, op. cit., Part III, pp. 1099-1100. Testimony of Benjamin J. Buttenweiser, a member of the firm of Kuhn, Loeb, and Company.

Mortgage Bank. The railways owned by the Government of Chile had been run at a loss in 1924.¹ Chile had not balanced its budget in 1924 or 1925. Chilean nitrate was coming more and more into competition with synthetic nitrates manufactured in Europe. In spite of these facts, the first Mortgage Bank loan was issued by Kuhn, Loeb, and Company in 1925. In 1926, the demand for natural Chilean nitrates weakened still further. In spite of this, Kuhn, Loeb, and Company issued an additional \$30,000,000 of Mortgage Bank loans in 1926.

In order further to inform the public, the managing and participating bankers issued prospectuses and advertisements concerning the loans which were in several cases inaccurate or misleading. In the case of the \$8,000,000 loan to the State of Minas Geraes, Brazil, managed by the National City Company, the statement was made in the prospectus: "The proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State."² As a matter of fact, about half of the loan, or \$4,000,000, was used to repay short-term advances made by the National City Company and associates.³ In spite of the fact that George F. Train, a member of the Foreign Department of the National City Company, had written from Rio de Janeiro criticizing the careless and negligent management of finances by officials of the State of Minas Geraes,⁴ the prospectuses of the loans of 1928 and 1929 to that state contained the statement: "Prudent and careful management of the State's finances has been characteristic of successive administrations in Minas Geraes."⁵

Chapter iii of "Dollar Bonds of South American Governments, 1919-30," deals with the "Use and Misuse of the Loans" by the South American governments. Only about 12 per cent of the dollar loans floated by the Republic of Argentina were used for public works, while 88 per cent were used in refunding short-term bankers' advances or the floating debt. This condition would indicate that most of the loans were used to defray budgetary deficits instead of adding to the wealth of the country by constructive

¹Ibid., p. 1102.

² Subcommittee of the Committee on Banking and Currency, op. cit., Part VI, p. 2137.

³Ibid., p. 2136.

⁴Ibid., p. 2155.

⁵Ibid., p. 2156.

public works.

Much of the proceeds of the Brazilian loans were wasted. In 1922, a \$25,000,000 loan was brought out by Dillon, Read, and Company for the United States of Brazil. The purpose of this loan was supposed to be the electrification of the suburban division of the Central Railway of Brazil.¹ Although at least some of the loan seems to have been spent on the improvement of the railway, the railroad was never electrified. The money for the electrification of the railroad was spent for other purposes, and the contract was never let.

There was considerable waste in the expenditure of the proceeds of the Peruvian loans. A large irrigation project in northern Peru was started, but never finished.² The public works cost, on the whole, about twice as much as they were worth.³ Two different concrete roads were constructed from Lima to Callao, Peru, when only one was needed. Roads were paved in waste places. The government railways were operated at a loss. The people were happily situated on the land, but the public works drew them into the city to work for seventy-five cents a day.⁴ When the work ceased, these people stayed on in the cities as a floating population without resources to return to the land.

Chapter iv, "The United States Government and the Loans," deals with the efforts of the Department of State and Department of Commerce to control foreign lending. Although the Department of State did not attempt to pass upon the soundness of the loans, the department had three general objectives: (1) to prevent the flotation of loans to countries which had failed to fund their public debts to the United States; (2) to promote certain humanitarian concepts such as the prevention of loans for military purposes; and (3) to prevent loans which would injure the economic and the financial interests of the people of the United States, such as international monopolies.⁵

¹Committee on Banking and Currency, Hearings, op. cit., Part IV, p. 1973. Testimony of Robert Otis Hayward, a member of the firm of Dillon, Read, and Company.

²Ibid., p. 2106.

³Committee on Finance, op. cit., Part III, p. 1599. Testimony of Lawrence Dennis, a financial expert formerly employed by J. and W. Seligman and Company.

⁴Ibid., p. 1601.

⁵J. T. Madden and M. Nadler, Foreign Securities (New York: The Ronald Press Company, 1929), pp. 226-27.

In spite of the objectives of the Department of State, loans were made to both Bolivia and Peru for military purposes. In the case of Bolivia, a \$23,000,000 loan of 1928 issued by Dillon, Read, and Company was used to the extent of \$5,061,000 to pay Vickers for munitions, and an additional \$1,500,000 was used by the minister of war to build military roads in El Gran Chaco.¹ In this case, the State Department did not object to the issue, since it was pointed out by the bankers that it was merely a re-funding of a prior contract. The loan was dated September, 1928, and three months later, in December, border hostilities took place between Bolivia and Paraguay.² Peru spent approximately \$1,000,000 out of various dollar loans for military purposes at the very time that the Tacna-Arica boundary dispute was in process of negotiation and arbitration by President Coolidge.³ The State Department does not seem to have noted these expenditures.

The Department of Commerce published various pamphlets and studies on Latin-American finance, but the department found it difficult to publish the information at the right time, and the readers of the publications were limited. In the case of the Bolivian loan of \$23,000,000, the Department of Commerce pointed out to the State Department that the loan was unsound, but the State Department made no objection to the loan because the diplomatic relations of the United States with Latin America were upset as a result of the Nicaraguan and Haitian policies of the United States. The State Department was fearful of being embarrassed at a forthcoming Pan-American conference if it objected to the loan.⁴

Chapter v, "The Defaults," relates the causes of default on their dollar bonds by six of the seven South American governments which borrowed dollars in the United States from 1919 to 1930. The principal cause of the defaults was the world-wide collapse in the prices of raw materials which South America exported

¹Committee on Finance, *op. cit.*, Part III, pp. 1585-86. Testimony of Lawrence Dennis, financial expert formerly employed by J. and W. Seligman and Company.

²*Ibid.*, p. 1894. Testimony of Francis White, Assistant Secretary of State.

³*Ibid.*, p. 1759. Testimony of Walter Kemmerer of Princeton University.

⁴*Ibid.*, Part II, pp. 724-25. Testimony of Grosvenor M. Jones of the Department of Commerce.

to the rest of the world. The economic difficulties were aggravated by boundary disputes and internal revolutions which made the defaults inevitable.

Bolivia was the first South American government to default upon its dollar bonds on January 1, 1931. In Bolivia, international economic disturbances, a boundary dispute, and internal revolution made default inevitable. The price of tin dropped two-thirds from 1928 to 1931.¹ Bolivia and Paraguay began border fighting in El Gran Chaco in December, 1928. This war required huge military expenditures which upset the economy of the nation. In June, 1930, the Bolivian government was overthrown by a military revolution.² For a time, a military junta governed the country, but this was followed by a constitutional government under President Salamanca.

Default in Peru followed much the same pattern as default in Bolivia. Peru was dependent upon cotton, petroleum, copper, and sugar for 85 per cent of her exports.³ These commodities declined about two-thirds in value. Previously a dispute had occurred over the Tacna-Arica territory which had involved heavy military and plebiscitary expenses before it was finally settled by the intervention and conciliation of the United States. Violent revolutionary outbursts made default inevitable. In August, 1930, the Legúía regime was overthrown by a military revolution.⁴ In February, 1931, further political disturbances broke out. During the first eleven days of March, Peru had four presidents.⁵

Argentina was the only one of the South American national governments which had borrowed dollars from the United States which did not at least partially default upon her bonds. Some of the Argentine provincial and municipal dollar bonds, however, are in partial or complete default. Argentina suffered economically to the same extent as Peru and Bolivia. Argentina was chiefly

¹New York Times, May 7, 1931, p. 40.

²J. Fred Rippy, Historical Evolution of Hispanic America (2d ed. rev.; New York: F. S. Crofts and Company, 1940), p. 327.

³Institute of International Finance, Special Bulletin on Securities in Default, No. 48, Republic of Peru, December 7, 1931 (New York: New York University Press, 1931), p. 12.

⁴Rippy, Historical Evolution, pp. 328-29.

⁵Institute of International Finance, Bull. No. 48, p. 9.

dependent upon cereals, linseed, and livestock products.¹ The value of these products declined about two-thirds. Argentina, however, had no boundary disputes during this period, and her political life was remarkably stable. In September, 1930, a group of army officers, led by General José Francisco Uriburu, staged a coup d'état, and removed President Irigoyen from office.² In November, 1931, general elections were held in which General Augustin Justo was elected president by a large majority. In spite of some disturbances, General Justo was successful in maintaining his control.

Chapter vi, "Present Status of the Bonds," relates the efforts of the dollar bondholders to collect their interest and principal from the debtor governments of South America, and the status of this effort at the end of 1939. In the case of the default of a state upon its public debt, the creditors have practically no legal method to compel payment. Theoretically, armed force might be used by a state in behalf of its citizens to force the resumption of debt service by a debtor state. This method, however, is prohibited by Convention II of the Hague Convention of 1907 which prohibits the use of force in the collection of contract debts, unless arbitration is refused.³ Intervention by the United States in the internal affairs of Latin-American states is outlawed by the "Convention on Rights and Duties of States" adopted at Montevideo in December, 1933, and by the "Additional Protocol" to this convention presented at Buenos Aires in 1936.⁴

Under such circumstances, the most effective method which holders of defaulted bonds can use is to establish an organization which may receive the good offices of the State Department and negotiate with the debtor states. Such an organization is the Foreign Bondholders Protective Council, which was organized under

¹Institute of International Finance, Bull. No. 62, Argentina, April 29, 1933 (New York: New York University Press, 1933), p. 8.

²Rippy, Historical Evolution, pp. 329-30.

³Carnegie Endowment for International Peace, Division of International Law, Pamphlet No. 11, The Hague Convention (II) of 1907 Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts (Washington: Carnegie Endowment, 1915), pp. 1-3.

⁴Charles Gray Bream, "Intervention Short of Armed Force in Latin America" (Unpublished Ph.D. dissertation, Department of International Relations, University of Chicago, 1941), pp. 10-11, 13-14.

the leadership of Raymond B. Stevens at the Treasury Department, Washington, District of Columbia, on December 18, 1933.¹ This organization has done excellent work in representing the bondholders in negotiations with defaulting governments.

All Bolivian national bonds are in complete default. At the end of 1939, there were in default \$59,422,000 of dollar bonds in principal amount and \$39,000,000 of defaulted interest.² All Peruvian dollar bonds, national, provincial, and municipal, are in complete default, but the British Guano loan is being serviced at 4 per cent interest and 2 per cent amortization per year.³ Partial interest is being paid upon Chilean national bonds, but they are not being amortized.⁴ The Chilean municipal bonds are in complete default both as to principal and interest. Partial service is being made upon some Brazilian bonds, while others are not being serviced at all.⁵ Partial service is being paid on two national loans of Colombia, but the remaining national, municipal, and departmental bonds are in complete default.⁶ The Colombian government repatriated large amounts of its own bonds at depreciated prices at the very time that it was in complete default in both interest and principal on these same bonds.⁷

Uruguay readjusted all her bonds, both national and municipal. The principal remained the same, but the interest was substantially reduced. At the end of 1939, over ninety per cent of the bondholders had exchanged their old bonds for the new readjustment bonds which were being paid in full.⁸ The National Government of Uruguay also took over the bonds issued by the City of

¹U. S. Securities and Exchange Commission, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part V, "Protective Committees and Agencies for Holders of Defaulted Foreign Governmental Bonds" (Washington: U. S. Printing Office, 1937), p. 13.

²Foreign Bondholders Protective Council, Annual Report, 1939 (New York: Foreign Bondholders Protective Council, 1940), p. 15.

³Ibid., Annual Report, 1938, p. 827.

⁴Poor's Governmentals and Municipals, Annual Report, 1941 (New York: Poor's Publishing Company, 1942), p. 51.

⁵Foreign Bondholders Protective Council, Annual Report, 1939, p. 22.

⁶Ibid., p. 31. ⁷Ibid., p. 30. ⁸Ibid., p. 62.

Montevideo, and issued readjustment bonds in exchange for them. The National Government of Argentina remained the only national government which had fulfilled her obligations in full. Argentina had reaped the benefits of this performance by refunding her bonds at lower rates of interest. Some of the dollar loans of Argentine provinces and municipalities were in partial or complete default, but the record was a favorable one as a whole. In November, 1939, the fiscal agents announced that they had brought a successful legal action against the City of Cordoba, Argentina, and received full judgment for both principal and interest. Furthermore, the court granted an attachment upon the pledged revenues of the city. This is the only case of which I know about the successful suit on behalf of bondholders against a governmental entity.

Chapter vii, "The New and the Old," compares the new system of lending to Latin America through the Export-Import Bank with the old system of private lending. All the common stock of the Export-Import Bank is held in the name of the United States.¹ The preferred stock is held by the Reconstruction Finance Corporation. From February 12, 1934, to August 15, 1941, the Export-Import Bank made commitments of \$229,694,029 to South American governments.² Brazil has been loaned \$20,000,000 for the development of her steel industry. On March 3, 1942, the bank made a commitment of an additional \$100,000,000 to develop the resources of the Amazon Valley. These loans are made in part to develop the standard of living and natural resources of South America. The banking method of making loans has the advantage over the old method of obtaining money through the sale of bonds in that the use of the funds may be more carefully watched since the money is allocated gradually instead of in one lump sum. The loans of the Export-Import Bank also seem to bear lower rates of interest than the old loans. Some persons will question the wisdom of the government taking an active part in the foreign banking business because of the possibility of using banking as a weapon of political penetration, but perhaps, as the Tennessee Valley Authority is a yardstick in the measurement of electric rates, so the Export-

¹Warren Lee Pierson, "A Report to the American People, I," Foreign Commerce Weekly, August 30, 1941, IV, No. 9 (Washington: U. S. Department of Commerce), 3.

²Ibid., p. 33.

Import Bank will be a yardstick in the methods used and the rates charged by American bankers in the foreign banking field.

In spite of the difficulties which American investors and American bankers have faced in the field of South American investment, capital at reasonable rates of interest and with adequate safeguards for the American investor will for a long time in the future be necessary for the vigorous and healthy growth of our South American neighbors. This capital will have to be furnished by private investors, or the United States government, or both.

